SECTION A (32 marks)

Answer ALL the questions in this section.

1. Explain the relationship between business finance and accounting discipline. (4 marks)

2. State **three** advantages of using **retained earnings** as a source of finance. (3 marks)

3. A company intends to raise extra finance using a 20% debenture. The corporation tax rate is 30%. Calculate the cost of the debenture. (3 marks)

4. Highlight **three** advantages/ functions of micro-finance institutions in Kenya. (3 marks)

5. The following information relates to Lite Limited for the year ended 31 December, 2009.

	Ksh
Cost of goods sold	360,000
Inventory (1st January, 2009)	48,000
Inventory (31st December, 2009)	51,000

Calculate the inventory period. (3 marks)

6. Mary invested Ksh 50,000 at a compound interest of 9% per annum. Calculate its future value after 25 years. (3 marks)

7. Highlight **two** disadvantages of using Pay Back Period(PBP) as a method of investment appraisal. (2 marks)

8. Differentiate between liquidity ratios and leverage ratios. (4 marks)

9. State **three** features of a debenture as a source of finance. (3 marks)

10. State **four** ways in which business finance is of importance to a financial manager in making investment decisions. (4 marks)

SECTION B (68 marks)

Answer ***ALL*** *the questions in this section.*

11. (a) Explain **four** factors that may influence the working capital requirements of a firm. (8 marks)

(b) Mr Shah intends to invest Ksh 2,500,000 at a future date. He plans to save Ksh 80,000 annually to achieve this goal. His savings will earn a return of 14% per annum. Calculate the length of time he will take to raise the money. (8 marks)

12. (a) Explain **four** functions of commercial banks in Kenya. (8 marks)

(b) A new company is planning to raise Ksh 300 million. The cost of debt is 14% and the cost of retained earning is 24.8%. Preferred stock will be sold at Ksh 110 and floatation costs of Ksh 10 will be incurred. The dividend per share is Ksh 18. The company's ordinary shares are currently being paid a dividend of Ksh 7 per share. The current market price is Ksh 45 per share. New ordinary shares issued will have a floatation cost of 15%. Earnings and dividends are expected to grow at the rate of 8% in the foreseeable future. The target capital structure is 30% debt, 10% preferred stock, 20% retained earnings and 40% ordinary shares.

(i) Calculate the weighted average cost of capital.

(ii) Determine how the Ksh 300 million will be distributed among the capital components.

(9 marks)

13. (a) Explain the importance of cost of capital in financial decision making. (8 marks)

(b) A firm intends to invest in either project A or project B. The expected cash flows are given below:

CASH FLOWS

YEAR	PROJECT A (Ksh '000')	PROJECT B (Ksh '000')
0	(2000)	(2000)
1	1,000	200
2	800	600
3	600	800
4	200	1,200

The required rate of return is 10%.

(i) Calculate:

(I) the Pay Back Period(PBP) for each project;
(II) Net Present Value(NPV) for each project.

(ii) Using the answers in (I) and (II) above, advise the firm on the project that they should invest in.

(10 marks)

14. (a) Explain **four** challenges faced in the implementation of the government initiative of providing the youth and women fund in Kenya. (8 marks)

(b) The following information relates to Thomed Limited.

	Ksh
Sales	2,500,000
Opening stock	328,750
Purchases	966,750
Closing stock	275,500
Selling, distribution, and administrative expenses	340,000

Calculate:

(i) gross profit ratio;
(ii) operating ratio;
(iii) stock turnover ratio.

(9 marks)